

## ACCOUNTING ILLUSTRATION

### ACCOUNTING FOR INVENTORIES WHEN USING STANDARD PRICE PRACTICES

#### A. GENERAL

1. The military departments record inventory at its standard [sales] price. As a rule, that value changes only once a year and is effective as of the first day of a fiscal year. The standard price includes cost recovery factors (commonly termed "surcharges") to recover operating costs and anticipate price inflation changes. The difference between the standard price of an inventory item and its acquisition cost is an unrealized gain which will not become realized until that item is classified as potential excess, sold or otherwise leaves the supply management stocking point. Holding gain and loss accounts have been established to accumulate the value of holding gains and losses during the fiscal year. When inventory is sold or otherwise disposed, the previously unrealized holding gain or loss is realized and recorded in account 1529.1A, "Realization of Holding Gains/Losses." The holding gain and loss accounts are:

*	1529.1A	Realization of Holding Gains/Losses
*	1529.1B	Purchases at Standard Price
*	1529.1C	Purchases at Cost
*	1529.1D	Materiel Returns at Standard Price
*	1529.1E	Materiel Returns - Credit Given
*	1529.1F	Materiel Returns Without Credit Given
*	1529.1G	Standard Price Changes-Gain
*	1529.1H	Accounting Adjustments-Gain
*	1529.1J	Assembly/Disassembly-Gain
*	1529.1K	Physical Inventory Adjustments-Gain
*	1529.1L	Incoming Shipments-Gain
*	1529.1M	Completed Inventory Repairs
*	1529.1N	Receipts of Materiel Without Charge
*	1529.1P	Other-Gain
*	1529.1Q	Latest Acquisition Cost Adjustment
*	1529.1R	Standard Price Changes-Loss
*	1529.1S	Accounting Adjustments-Loss
*	1529.1T	Assembly/Disassembly-Loss
*	1529.1U	Physical Inventory Adjustments-Loss
*	1529.1V	Incoming Shipments-Loss
*	1529.1W	Shrinkage and Other Adjustments-Loss
*	1529.1X	Actual Repair Costs
*	1529.1Y	Issues Without Reimbursement
*	1529.1Z	Other-Loss

NOTE: Every event that results in a change in the standard price value of existing inventory should be reflected in one of the holding gain or loss accounts specified above. If one of the above accounts is not descriptive of a recurring and significant inventory event that affects the value of inventory at standard price, then an additional holding gain/loss subaccount(s) should be requested to be established for that purpose. Such requests should be forwarded to the Director for Accounting Policy, Office of the Under Secretary of Defense (Comptroller/Financial Management).

2. Through use of the above allowance accounts, inventories should be reported on the Statement of Financial Condition and Cost of Goods Sold at latest acquisition cost and operating results should not be adversely affected by unrealized gains and losses in inventory values and differences between monthly and annual reporting processes.

3. For financial statement presentation, inventory is shown at its latest acquisition cost. The cost of inventory items sold is shown, in accordance with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," at an approximation of its historical (actual) cost. The inventory accounts minus the unrealized gains or losses amount in the allowance account will approximate inventory at acquisition cost.

4. The following illustration provides an explanation of the accounting necessary to properly record the DBOF supply management inventory for those supply management business areas which maintain inventory values at standard (selling) price. The illustration demonstrates the affect on unrealized holding gains due to standard price adjustments, purchases, inventory returns, and other transactions. The illustration also demonstrates the computations necessary to properly adjust cost of goods sold to the actual cost of the items sold.

5. The accounting for, and reporting of, inventory requires the cooperation of, and information from, both the entity at which daily transactions occur and the entity that uses the transaction data. For reporting purposes, the transactions described herein may be recorded at the reporting level if the transaction level does not have the capability to do so at this time. As soon as systems permit, the transactions should all be recorded at the transaction level. Many, but not all, of the accounting entries contained within this addendum should be prepared at the transaction level. The transaction level should be able to recognize many of the holding gain and loss accounts as a reclassification of existing accounts. The significant difference is that those accounts are classified differently than they were previously. The reclassification was necessary so that the unrealized holding gain or loss would be recognized only when inventory is sold or otherwise leaves the supply management stocking point.

6. Roughly, the following steps shall be performed in accounting for, and reporting of, inventory at its latest acquisition cost. The following direction must be consistently followed. Any changes to the following steps should be proposed to the Director for Accounting Policy, Office of the Under Secretary of Defense (Comptroller/Financial Management). DoD Component system or other differences may require deviation from the following steps; however, prior to implementation, those deviations must be approved by the Director for Accounting Policy.

Step 1 Establish initial inventory allowance account to identify cost recovery factors, prior year inflation, repair costs, and write-down of potential excess at the amount of the last adjustment contained in the FY 1994 Chief Financial Officer Act financial report submission. (NOTE: This is a one-time step to initially establish the allowance account at the same value as reported on the prior year CFO submission. For following years, the

inventory allowance account will be continued at its then current amount.)

Step 2 Monthly, stratify on-hand inventory by authorized levels using most current stratification data available. (Currently, inventory stratification data is updated only quarterly. That data, when received, is the most current stratification data available and shall be used for 3 months until the next quarterly stratification report is available.) Stratification levels include:

- Approved acquisition level
- Authorized retention
- Potential excess

Step 3 Stratify on-hand inventory by:  
Reparables  
Non-Reparables (Consumables)

Step 4 Stratify on-hand inventory by:  
Serviceable  
Unserviceable

Step 5 Remove cost recovery factors (i.e., surcharges) and, if applicable, prior year inflation factors from all on-hand inventories.

Step 6 For unserviceable portion of on-hand reparable inventories, remove repair cost percentage.

Step 7 For potential excess and unserviceable portion of non-reparable on-hand inventories, adjust to net realizable value. (Annually, the adjustment percentage changes. Currently, it is approximately 2 percent of sales price.)

Step 8 For in-transit inventories, determine:  
Amount from contractors  
Amount of reparable  
Serviceable  
Unserviceable

Step 9 For in-transit inventories, determine if:  
Amount from contractors is at acquisition cost  
Amount of reparable is at sales price less cost recovery and inflation factors and repair cost

Step 10 For in-transit inventories, remove, cost recovery factor (i.e., surcharges) and prior year inflation factors

Step 11 For unserviceable portion of in-transit reparable inventories, remove repair cost percentage if necessary

Step 12 For non-reparable portion of in-transit unserviceable inventories, adjust to net realizable value

Step 13 prepare journal vouchers to record in the allowance account all gains and losses to inventory occurring during the month, e.g.

Purchases at sales price and purchases at cost  
Customer returns without cost  
Sales price gains and losses  
Physical inventory and accounting gains and losses  
Incoming shipments gains and losses  
Shrinkage, damage, and other losses

Step 14 prepare journal vouchers to record decrease in allowance account based upon the percentage of allowance account to inventory times total sales for:

Sales to customers  
Transfers to disposal

Step 15 Prepare journal vouchers at the end of the month to adjust on-hand and in-transit inventories as described above in order to establish inventory at latest acquisition cost.

**B. MONTH ONE**

1. ESTABLISH INITIAL INVENTORY ALLOWANCE AMOUNT. As of October 1, 1994, general ledger account 1529.1, "Allowance for Holding Gain/Loss - Inventory Held for Sale," general ledger account 1529.2, "Allowance for Holding Gain/Loss - Inventory Held in Reserve for Future Sale," and general ledger account 1529.3, "Allowance for Repairs," should be established to identify cost recovery factors (i.e., surcharges), prior year inflation, repair costs, and write-down of potential excess at the same amount of the last adjustment contained in the FY 1994 Chief Financial Officer Act financial report submission. This is a one-time step to initially establish the allowance account at the same value as reported on the prior year CFO submission. For following years, the inventory allowance account will be continued at its then current amount. For illustration purposes, assume the initial allowance amount for "Inventory Held For Sale" is \$7,000. The following tables are included to assist in the understanding of the inventory accounting process. The entries may be made at the transaction level or summarized at the monthly reporting level but not at both levels. The table to illustrate the beginning inventory position for "Inventory Held for Sale," is:

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500

## 2. ADJUSTMENT OF INVENTORY TO NEW STANDARD PRICE

Dr 1521 Inventory Held for Sale	\$ 500
Cr 1529.1G Standard Price Changes-Gain	\$ 500

Entry to adjust value of inventory items in stock to the now current standard price when the recorded value of those items at the prior standard price was LESS than the now current standard price.

[Assume that 100 items are in inventory, the previous standard price was \$345 per item. and the allowance account had a credit beginning balance of \$7,000. Those items require revaluation to the current \$350 standard price. The revaluation will then require a \$500 adjustment -- 100 items @ \$5 adjustment per item = \$500.]

NOTE: Gains or losses associated with the valuation of inventory, although recognized, are not realized. Realization of the gain or loss occurs only when an item of inventory is sold or otherwise leaves the supply management stocking point.

Additionally, gains or losses recorded to the allowance account is the difference in amount between the standard price of a commodity item and the amount, if any, paid for that item, i.e., the difference between purchases at standard and purchases at cost. The Allowance for Gain/Loss account may be affected for a myriad of reasons -- increases/decreases to the standard price; differences between standard price and purchase cost; returns without credit; returns with partial credit, items "found" during physical inventory; etc.

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$-0-

## 3. PURCHASE OF INVENTORY ITEMS

	Dr 1521 Inventory Held for Sale	\$3,500 <u>1/</u>
*	Cr 1529.1B Purchases at Standard Price	\$3,500 <u>1/</u>
	Dr 1529.1C Purchases at Cost	\$3,000 <u>2/</u>
*	Cr 2110 Applicable Accounts Payable	\$3,000 <u>2/</u>

- 1/ The standard price of each item is \$350 (10 x \$350 = \$3,500)  
 2/ The purchase cost of each item is \$300 (10 x \$300 = \$3,000)  
 The unrealized gain per item is \$3,500 - \$3,000 = \$ 500

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$-0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000

#### 4. CUSTOMER RETURNS OF MATERIAL WITHOUT CREDIT

Dr 1521 Inventory Held for Sale \$1,050  
 \* Cr 1529.1F Materiel Returns Without Credit Given \$1,050

Entry to record a return of 3 inventory items from customers for which a credit is not granted. The Standard Price of each item is \$350 (3 x \$350 = \$1,050).

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$-0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$-0-

#### 5. CUSTOMER RETURNS OF MATERIAL WITH CREDIT

Dr 1521 Inventory Held for Sale \$1,050 1/  
 Cr 1529.1D Materiel Returns at Standard \$1,050 1/

Dr 1529.1E Materiel Returns - Credit Given \$ 600 2/  
 Cr 1311 Accounts Receivable-Government-Current \$ 600 2/

Entry to record a return of 3 inventory items from customers for which a credit of \$200 per item is granted.

1/ The Standard Price of each item is \$350 (3 x \$350 = \$1,050).

2/ \$200 credit per item x 3 items = \$600

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$-0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$-0-
B.5.	3	\$ 1,050	\$ 450	\$ 600

6. SALE OF INVENTORY WITHOUT AN EXCHANGE

Dr 1311 Accounts Receivable-Government - Current \$14,000 1/  
 Cr 5101 Revenue from Goods Sold - DBOF \$14,000 1/

Dr 6500 Cost of Goods Sold \$14,000 2/  
 Cr 1521 Inventory Held for Sale \$14,000 2/

Entry to record sale of inventory and the associated cost of the goods sold. (Although the revenue and the cost of goods sold are, under the standard price method, initially recorded at the same value, a month-end adjusting entry adjusts the balance recorded as Cost of Goods Sold to the actual cost.)

- 1/ 40 items are sold for \$350 per item for a total of \$14,000.  
2/ The standard price is \$350 per item for a total inventory reduction of \$14,000 (40 items x \$350 = \$14,000). [See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$ -0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$ -0-
B.5.	3	\$ 1,050	\$ 450	\$ 600
B.6.	(40)	(\$14,000)		N/A

7. SALE OF INVENTORY WITH AN EXCHANGE

Dr 1523.1 Exchange (DLR) Inventory in Transit	\$5,250	1/
Dr 1311 Accounts Receivable-Government-Current	\$2,700	2/
Cr 5101 Revenue from Goods Sold - DBOF	\$5,250	3/
Cr 1529.3A Estimated Repair Costs	\$1,650	4/
Cr 1529.3B Allowance for Surcharge	\$1,050	5/
Dr 6500 Cost of Goods Sold	\$5,250	6/
Cr 1521 Inventory Held for Sale	\$5,250	6/

Entry to record sale of inventory and the associated cost of the goods sold when a reparable item is exchanged for a ready for issue item. Fifteen carcasses are exchanged for ready for issue items.

- 1/ 15 carcasses needing repair are to be sent, but have not yet been sent, in partial exchange for the items sold. The in-transit carcasses are recorded in Account 1523.1, "Exchange (DLR) Inventory in Transit," at their standard price of \$5,250 [\$350 Standard Price x 15 carcasses = \$5,250. An estimated repair cost is established -- see note 4/ below.)
- 2/ The \$2,700 amount billed is the difference between the \$5,250 standard price of the items less the \$2,550 value of the exchanged carcasses.
- 3/ 15 items sold for \$350 per item = \$5,250
- 4/ 15 carcasses x \$110 estimated cost to repair a carcass = \$1,650
- 5/ Approximate surcharge included in ready for issue inventory items. In this case, about 20%. [20% x \$5250 = \$1050]
- 6/ The standard price is \$350 per item for a Inventory Held for Sale reduction of \$5,250 (15 items x \$350 = \$5,250). [See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$ -0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$ -0-
B.5.	3	\$ 1,050	\$ 450	\$ 600
B.6.	(40)	(\$14,000)		N/A
B.7.	(15)	(\$ 5,250)		N/A



Exchange (DLR) Inventory in Transit				
Transaction	Quantity	Standard Price	Allowance for Repair	Amount Paid (Cost)
B.7.	15	\$ 5,250	\$ 2,700	\$ 2,550

8. RECEIPT OF EXCHANGE (DLR) INVENTORY

Dr 1523 Inventory Held for Repair \$5,250  
 Cr 1523.1 Exchange (DLR) Inventory in Transit \$5,250

Entry to record receipt of exchange (DLR) inventory. The exchange item is recorded at its standard price. (A standard allowance for repair was established at the time the exchange transaction occurred -- see #7 above.)

Inventory Held for Repair				
Transaction	Quantity	Standard Price	Allowance for Repair	Amount Paid (Cost)
B.8.	15	\$ 5,250	\$ 2,700	\$ 2,550

Exchange (DLR) Inventory in Transit				
Transaction	Quantity	Standard Price	Allowance for Repair	Amount Paid (Cost)
B.7.	15	\$ 5,250	\$ 2,700	\$ 2,550
B.8.	(15)	(\$ 5,250)	<del>\$ 2,700</del>	<del>\$ 2,550</del>
Total	-0-	-0-	-0-	-0-

9. REVALUATION OF EXCESS OR BEYOND REPAIR INVENTORY

Inventory is revalued to its net realizable value (approximately, 2 percent of standard price) when (1) it is stratified as potential reutilization/disposal [i.e., potential excess], (2) regardless of stratification level, carries a condition code of "H - Condemned," "P - Reclamation," or "S - Scrap," or (3) determined to be beyond repair [i.e., not able to be repaired]. The loss on revaluation writedown shall be recognized in the period in which the writedown occurs. The loss shall not include unrealized gains associated with

that inventory. The illustration below is to recognize the loss associated with items stratified as potential excess.

Dr 1524	Inventory - Excess, Obsolete, and Beyond Repair	\$ 70 1/
Dr 1529.1A	Realization of Holding Gains/Losses	\$ 819 2/
Dr 7291.2	Excess/Obsolescence/Spoilage Loss	\$2,611 3/
Cr 1521	Inventory Held for Sale	\$3,500 1/

Entry to reclassify inventory items when those items are stratified as potential excess. In this illustration, 10 items with a carrying value of \$350 per item = \$3,500 were declared potential excess.

[NOTE: In this illustration, these potential excess items are to be subsequently transferred to reutilization. See "Month 2," transaction 3 on pages 85-86.]

- 1/ 10 items with a Standard Price of \$350 per item = \$3,500 were determined potentially excess. Items declared potentially excess should be valued at net realizable value (currently, approximately 2 percent of standard price).
- 2/ When items move between inventory categories, the allowance accounts in the respective inventory categories are decreased/increased respectively. In this case, items are moving from the "Inventory Held for Sale" category to the "Inventory - Excess, Obsolete, and Beyond Repair" category. The amount of the allowance is determined through use of the percentage amount determined in the month-end adjustment of cost of goods (see item 10 below). The percentage amount, in this illustration, is 76.60 percent.  $76.60 \text{ percent} \times \$3,500 = \$2,681 - \$3,500 = \$819$ .
- 3/ The \$3500 carrying value of the inventory less the \$70 salvage value and less the \$819 allowance equals the \$2,611 loss.

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$ -0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$ -0-
B.5.	3	\$ 1,050	\$ 450	\$ 600
B.6.	(40)	(\$14,000)		N/A
B.7.	(15)	(\$ 5,250)		N/A
B.9.	(10)	(\$ 3,500)	(\$ 819)	N/A

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	2% of Standard Price	Allowance Amount	Amount Paid (Cost)
B.9.	10	\$ 70	N/A	N/A

10. MONTH END ADJUSTMENT OF INVENTORY VALUES TO LATEST ACQUISITION COST

a. The preceding processes are designed for those DBOF supply management business areas maintaining inventory values at standard [selling] price. For financial statement presentation, the inventory values at standard [selling] price must be adjusted to latest acquisition cost. DoD Components that value inventory at the standard (selling) price of that inventory shall revalue that inventory to its latest acquisition cost for financial reporting purposes.

b. The procedure to revalue inventory to its latest acquisition cost is to deduct the cost recovery (surcharge) amount and, if applicable, the prior year inflation amount from both the inventory at standard price value and the allowance for holding gain and loss account. For example, assume that the surcharge factor is 15 percent. Then, inventory at standard price would be reduced in valuation by 15 percent with an equal reduction (by dollar amount, not percentage amount) made to the allowance for holding gain loss account. If the potential excess and beyond repair (i.e., not repairable) inventory has been previously recorded in the financial inventory category, "Inventory - Excess, Obsolete, and Beyond Repair," should be recorded at its net realizable value and does not have an allowance account associated with it. If the entry to adjust the value of potential excess inventory has not been previously made, as indicated in transaction B.9. above, then the entry should be made at this time. The end-of-month entries to adjust inventory recorded at standard [selling] price to its latest acquisition cost are:

INVENTORY HELD FOR SALE

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q Latest Acquisition Cost Adjustment	\$2,675	
Cr 1521 Inventory Held for Sale		\$2,675

### INVENTORY HELD FOR REPAIR

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.3B	Estimated Exchange Costs	\$1,050	
Cr 1523	Inventory Held for Repair		\$1,050

NOTE: The following inventory accounts are not used in this illustration. However, the month-end adjusting entry for them, when they are applicable, are as follows:

### INVENTORY IN TRANSIT FROM PROCUREMENT

Generally, inventory in transit from commercial sources is at acquisition cost and no month-end adjustment is necessary. However, if inventory in transit from commercial sources is valued at standard price, then the following is necessary to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q	Latest Acquisition Cost Adjustment	
Cr 1521.1	Inventory in Transit from Procurement	

### INVENTORY IN TRANSIT FROM DoD ENTITIES

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q	Latest Acquisition Cost Adjustment	
Cr 1521.2	Inventory in Transit from DoD Entities	

### INVENTORY HELD FOR FUTURE SALE

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.2 Allowance for Holding Gain/Loss -  
 Inventory Held for Future Sale  
 Cr 1522 Inventory Held for Future Sale

c. The result of applying the adjustment shall result in an equal, but opposite, adjustment for financial statement presentation purposes to the ending inventory value and that inventory's unrealized holding gain as shown below:

<u>Inventory Category</u>	<u>Standard Price</u>	<u>Adjustment Amount</u>	<u>Latest Acquisition Cost</u>
Inventory Held For Sale	\$17,850	\$2,675	\$15,175
Inventory Held for Repair	\$ 5,250	\$1,050	\$ 4,200
TOTAL	\$23,100	\$3,725	\$19,375

<u>Allowance Category</u>	<u>Pre-Adjustment Value</u>	<u>Adjustment Amount</u>	<u>Post-Adjustment Value</u>
Latest Acquisition Cost Adjustment	\$4,177	\$2,675	\$1,502
Allowance for Repair	\$2,700	\$1,050	\$1,650
TOTAL	\$6,877	\$3,725	\$3,152

d. The end of month adjustments shown above shall be reversed immediately after financial statement preparation. The reversing entries are:

#### INVENTORY HELD FOR SALE

Dr 1521 Inventory Held for Sale \$2,675  
 Cr 1529.1Q Latest Acquisition Cost Adjustment \$2,675

#### INVENTORY HELD FOR REPAIR

Dr 1523 Inventory Held for Repair \$1,050  
 Cr 1529.3B Estimated Exchange Costs \$1,050

NOTE: The following inventory accounts are not used in this illustration. However, the month-end adjusting entry for them, when they are applicable, are as follows:

#### INVENTORY IN TRANSIT FROM PROCUREMENT

Dr 1521.1 Inventory in Transit from Procurement  
 Cr 1529.1Q Latest Acquisition Cost Adjustment

#### INVENTORY IN TRANSIT FROM DoD ENTITIES

Dr 1521.2 Inventory in Transit from DoD Entities  
 Cr 1529.1Q Latest Acquisition Cost Adjustment

#### INVENTORY HELD FOR FUTURE SALE

Dr 1522 Inventory Held for Future Sale  
 Cr 1529.2 Allowance for Holding Gain/Loss -  
 Inventory Held for Future Sale

11. MONTH-END ADJUSTMENT OF COST OF GOODS SOLD

Dr 1529.1A	Realization of Holding Gains/Losses	\$4,504 <u>1/</u>
Cr 6500	Cost of Goods Sold	\$4,504 <u>1/</u>

In the preceding entries (transactions B.6. and B.7.), account 6500, "Cost of Goods Sold," was debited for the standard price of inventory sold. The purpose of this entry is to adjust account 6500 to the cost (vice standard price) of inventory sold. The standard price (i.e., sales price) will generally be more than the cost due to the inclusion of cost recovery elements in the selling price.

1/

INVENTORY HELD FOR SALE

	Cost	Unrealized <u>Gain</u>	Standard <u>Price</u>
Beginning Inventory	\$27,500	\$7,000	\$34,500
Price Change		\$ 500	\$ 500
Purchases	<u>\$ 3,600</u>	<u>\$2,000</u>	<u>\$ 5,600</u>
TOTAL	<u>\$31,100</u>	<u>\$9,500</u>	<u>\$40,600</u>
Excess Inventory	(\$ 2,681)	(\$ 819)*	(\$ 3,500)
Cost of Goods Sold	<u>(\$14,746)</u>	<u>(\$4,504)*</u>	<u>(\$19,250)</u>
Ending Inventory (at Standard)	\$13,673	\$4,177	\$17,850
LAC Adjustment (see B.10.)		<u>(\$2,675)</u>	<u>(\$ 2,675)</u>
Ending Inventory (at LAC)		<u>\$1,502</u>	<u>\$15,175</u>

• Cost of Goods Sold Computation

\$9,500 Unrealized Gain + \$40,600 Standard Price = .234  
.234 x \$3,500 Excess Inventory at Standard Price = \$819 gain reduction  
.234 x \$19,250 Goods Sold at Standard Price = \$4,504 realized gain  
\$19,250 Goods Sold at Standard Price - \$4,504 realized gain = \$14,746

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$ -0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$1,050	\$ -0-
B.5.	3	\$ 1,050	\$ 450	\$ 600
B.6.	(40)	(\$14,000)		N/A
B.7.	(15)	(\$ 5,250)		N/A
B.9.	(10)	(\$ 3,500)	(\$ 819)	N/A
B.11.	-0-		(\$4,504)	(\$14,746)
Total	51	\$17,850	\$4,177	\$13,673

**FINANCIAL STATEMENT PRESENTATION**  
**(Prior to LAC Adjustment)**  
**MONTH ONE**

<u>Cost of Material Sold from Inventory</u>	<u>Inventory Held For Sale</u>	<u>Inventory Held For Future Sale</u>	<u>Excess Inventory</u>	<u>Inventory Held for Repair</u>	<u>Total</u>
(1) Beginning Inventory	\$34,500			\$ -0-	\$34,500
(a) Less: Beginning Allowance	\$ 7,000				\$ 7,000
(b) Plus: Purchases at Cost	\$ 3,000				\$ 3,000
(c) Plus: Customer Returns - Credit Given	\$ 600				\$ 600
(d) Plus: DLR Exchange Credits				\$2,550	\$ 2,550
(e) Less: Inventory Losses Realized	\$2,611				\$2,611
Internal Movements between Inventory Classifications	(\$ 70)		\$ 70		\$ -0-
(2) Less: Ending Inventory	\$17,850		\$ 70	\$5,250	\$23,170
(a) Plus: Ending Allowance	\$ 4,177			\$2,700	\$ 6,877
Cost of Goods Sold	\$14,746		\$ -0-	\$ -0-	\$14,746



**FINANCIAL STATEMENT PRESENTATION**  
**(After LAC Adjustment)**  
**MONTH ONE**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Inventory Held for Repair	Total
(1) Beginning Inventory	\$29,500			\$ -0-	\$29,500
(a) Less: Beginning Allowance	\$ 2,000				\$ 2,000
(b) Plus: Purchases at Cost	\$ 3,000				\$ 3,000
(c) Plus: Customer Returns - Credit Given	\$ 600				\$ 600
(d) Plus: DLR Exchange Credits				\$2,550	\$ 2,550
(e) Less: Inventory Losses Realized	\$2,611				\$2,611
Internal Movements between Inventory Classifications	(\$ 70)		\$ 70		\$ -0-
(2) Less: Ending Inventory	\$15,175		\$ 70	\$4,200	\$19,445
(a) Plus: Ending Allowance	<u>\$ 1,502</u>			<u>\$1,650</u>	<u>\$ 3,152</u>
Cost of Goods Sold	\$14,746		\$ -0-	\$ -0-	\$14,746

C. MONTH TWO

1. PURCHASE OF INVENTORY ITEMS

Dr 1521 Inventory Held for Sale \$8,750 1/  
 Cr 1529.1B Purchases at Standard Price \$8,750 1/

Dr 1529.1C Purchases at Cost \$7,750 2/  
 Cr 2110 Applicable Accounts Payable Series \$7,750 2/

1/ The standard price of each item is \$350 (25 x \$350 = \$8,750)

2/ The purchase cost of each item is \$310 (25 x \$310 = \$7,750)

The unrealized gain per item is \$8,750 - \$7,750 = \$1,000

Entry to record \$310 per item purchase of 25 inventory items with a standard price of \$350 per item.

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750

2. REPAIR OF EXCHANGED INVENTORY

Dr 1521 Inventory Held for Sale \$4,550 1/  
 Dr 1524 Inventory - Excess, Obsolete, and Beyond Repair \$ 14 2/  
 Dr 7291.2 Excess/Obsolescence/Spoilage Loss \$ 686 3/  
 Cr 1523 Inventory Held for Repair \$5,250 4/

Dr 1529.1X Actual Repair Costs \$1,500 5/  
 Cr 2111 Accounts Payable-Government-Current \$1,500 5/

Dr 1529.3A Estimated Repair Costs \$1,650 6/  
 Dr 1529.3B Estimated Exchange Costs \$1,050 6/  
 Cr 1529.1M Completed Inventory Repairs \$2,700 6/

- 1/ \$4,550 = the \$350 Standard Price x 13 repaired items. [Note that this amount does not equal the \$5,250 amount recorded in account 1523, "Inventory Held for Repair." In this illustration, the reason for this is because although 15 items were sent for repair, the repair facility determined that 2 of the 15 exchanged items could not be repaired. [\$350 Standard Price per item x 2 items = \$700. \$5,250 - \$700 = \$4,550].
- 2/ Two of the carcasses could not be repaired. The standard price of the items was \$350 x 2 items = \$700. The net realizable value is approximately 2 percent. \$700 x 2% = \$14.

- 3/ The loss is equal to the \$700 standard price of the two items less the \$14 net realizable value = \$686.
- 4/ Upon receipt of repaired items, GLA 1523, "Inventory Held for Repair," is always reduced (credited) in the amount that was established for the repaired items.
- 5/ 13 of the exchanged carcasses could be repaired. \$1,500 was the amount charged by the repair facility for 13 repaired carcasses.
- 6/ Upon receipt of repaired items, GLA 1529.3A and GLA 1529.3B are always reduced (debited) in the amount that was established for the repaired items.

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750
C.2.	13	\$ 4,550	\$1,200	\$ 3,350

Inventory Held For Repair				
Transaction	Quantity	Standard Price	Allowance for Repair	Amount Paid (Cost)
B.8.	15	\$ 5,250	\$ 2,700	\$ 2,550
C.2.	(15)	(\$ 5,250)	(\$ 2,700)	(\$ 2,550)
Total	-0-	-0-	-0-	N/A

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	2% of Standard Price	Allowance Amount	Amount Paid (Cost)
B.9.	10	\$ 70	N/A	N/A
C.2.	2	\$ 14	N/A	N/A



Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750
C.2.	13	\$ 4,550	\$1,200	\$ 3,350
C.4.	6	\$ 2,100	\$ 2,100	N/A

5. SALE OF INVENTORY WITHOUT AN EXCHANGE

Dr 1311 Accounts Receivable-Government - Current      \$22,750 1/  
           Cr 5101 Revenue from Goods Sold - DBOF                      \$22,750 1/

Dr 6500 Cost of Goods Sold                                      \$22,750 2/  
           Cr 1521 Inventory Held for Sale                                      \$22,750 2/

Entry to record sale of inventory and the associated cost of the goods sold. The sales price will generally be more than the latest acquisition cost due to the inclusion of cost recovery elements in the selling price.

1/ 65 items are sold for \$350 per item for a total of \$22,750.

2/ The standard price is \$350 per item for a total inventory reduction of \$22,750 (65 items x \$350 = \$22,750). [See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750
C.2.	13	\$ 4,550	\$1,200	\$ 3,350
C.4.	6	\$ 2,100	\$2,100	N/A
C.5.	(65)	(\$22,750)		

## 6. MONTH END ADJUSTMENT OF INVENTORY VALUES TO LATEST ACQUISITION COST

a. The procedure to revalue inventory to its latest acquisition cost is to deduct the cost recovery (surcharge) amount and, if applicable, the prior year inflation amount from both the inventory at standard price value and the allowance for holding gain and loss account. For example, assume that the surcharge factor is 15 percent. Then, inventory at standard price would be reduced in valuation by 15 percent with an equal reduction (by dollar amount, not percentage amount) made to the allowance for holding gain loss account. If the potential excess and beyond repair (i.e., not repairable) inventory has been previously recorded in the financial inventory category, "Inventory - Excess, Obsolete, and Beyond Repair," should be recorded at its net realizable value and does not have an allowance account associated with it. If an entry to adjust the value of potential excess inventory has not been previously made, then the entry should be made at this time. The end-of-month entries to adjust inventory recorded at standard [selling] price to its latest acquisition cost are:

### INVENTORY HELD FOR SALE

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q	Latest Acquisition Cost Adjustment	\$1,575
Cr 1521	Inventory Held for Sale	\$1,575

NOTE: The following inventory accounts are not used in this illustration. However, the month-end adjusting entry for them, when they are applicable, are as follows:

### INVENTORY HELD FOR REPAIR

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.3B	Estimated Exchange Costs
Cr 1523	Inventory Held for Repair

### INVENTORY IN TRANSIT FROM PROCUREMENT

Generally, inventory in transit from commercial sources is at acquisition cost and no month-end adjustment is necessary. However, if inventory in transit from commercial sources is valued at standard price, then the following is necessary to remove, for financial reporting purposes, surcharges [and, if applicable, prior

year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q Latest Acquisition Cost Adjustment  
 Cr 1521.1 Inventory in Transit from Procurement

#### INVENTORY IN TRANSIT FROM DoD ENTITIES

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q Latest Acquisition Cost Adjustment  
 Cr 1521.2 Inventory in Transit from DoD Entities

#### INVENTORY HELD FOR FUTURE SALE

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.2 Allowance for Holding Gain/Loss -  
 Inventory Held for Future Sale  
 Cr 1522 Inventory Held for Future Sale

b. The result of applying the adjustment factor shall result in an equal, but opposite, adjustment for financial statement presentation purposes to the ending inventory value and that inventory's unrealized holding gain as shown below:

<u>Inventory Category</u>	<u>Standard Price</u>	<u>Adjustment Amount</u>	<u>Latest Acquisition Cost</u>
Inventory Held For Sale	\$10,500	\$1,575	\$8,925
<u>Allowance Category</u>	<u>Pre-Adjustment Value</u>	<u>Adjustment Amount</u>	<u>Post-Adjustment Value</u>
Latest Acquisition Cost Adjustment	\$2,677	\$1,575	\$1,102

c. The end of month adjustments shown above shall be reversed immediately after financial statement preparation. The reversing entries are:

#### INVENTORY HELD FOR SALE

Dr 1521 Inventory Held for Sale	\$1,575
Cr 1529.1Q Latest Acquisition Cost Adjustment	\$1,575

NOTE: The following inventory accounts are not used in this illustration. However, the month-end adjusting entry for them, when they are applicable, are as follows:

#### INVENTORY HELD FOR REPAIR

Dr 1523 Inventory Held for Repair	
Cr 1529.3 Allowance for Repairs	

#### INVENTORY IN TRANSIT FROM PROCUREMENT

Dr 1521.1 Inventory in Transit from Procurement	
Cr 1529.1Q Latest Acquisition Cost Adjustment	

#### INVENTORY IN TRANSIT FROM DoD ENTITIES

Dr 1521.2 Inventory in Transit from DoD Entities	
Cr 1529.1Q Latest Acquisition Cost Adjustment	

#### INVENTORY HELD FOR FUTURE SALE

Dr 1522 Inventory Held for Future Sale	
Cr 1529.2 Allowance for Holding Gain/Loss - Inventory Held for Future Sale	

#### 7. MONTH-END ADJUSTMENT OF COST OF GOODS SOLD

Dr 1529.1A Realization of Holding Gains/Losses	\$5,800 <u>1/</u>
Cr 6500 Cost of Goods Sold	\$5,800 <u>1/</u>

In the preceding entry (transaction C.5.), account 6500, "Cost of Goods Sold," was debited for the standard price of inventory sold. The purpose of this entry is to adjust account 6500 to the cost (vice standard price) of inventory sold. The standard price (i.e., sales price) will generally be more than the cost due to the inclusion of cost recovery elements in the selling price.

1/ (See Following Page)



1/

## INVENTORY HELD FOR SALE

	Cost	Unrealized Gain	Standard Price
Beginning Inventory	\$13,673	\$4,177	\$17,850
Repaired DLR Transfer	\$ 3,350	\$1,200	\$ 4,550
Gains on Inventory		\$2,100	\$ 2,100
Purchases	<u>\$ 7,750</u>	<u>\$1,000</u>	<u>\$ 8,750</u>
TOTAL	<u>\$24,773</u>	<u>\$8,477</u>	<u>\$33,250</u>

Cost of Goods Sold	(\$16,950)*	(\$5,800)*	(\$22,750)
Ending Inventory (at Standard)	\$ 7,823	\$2,677	\$10,500
LAC Adjustment (see C.6.)		(\$1,575)	(\$ 1,575)
Ending Inventory (at LAC)		<u>\$1,102</u>	<u>\$ 8,925</u>

## \* Cost of Goods Sold Computation

\$8,477 Unrealized Gain + \$33,250 Standard Price = .2549

.2549 x \$22,750 Goods Sold at Standard Price = \$5,800 realized gain

\$22,750 Goods Sold at Standard Price - \$5,800 realized gain = \$16,950

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750
C.2.	13	\$ 4,550	\$1,200	\$ 3,350
C.4.	6	\$ 2,100	\$2,100	
C.5.	(65)	(\$22,750)		
C.7.		(\$22,750)	(\$5,800)	(\$16,950)
Total		\$10,500	\$2,677	\$7,823

**FINANCIAL STATEMENT PRESENTATION**  
**(Prior to LAC Adjustment)**  
**MONTH TWO**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Inventory Held for Repair	Total
(1) Beginning Inventory	\$17,850		\$ 70	\$5,250	\$23,170
(a) Less: Beginning Allowance	\$ 4,177			\$2,700	\$ 6,877
(b) Plus: Purchases at Cost	\$ 7,750			\$1,500	\$ 9,250
(c) Plus: Customer Returns - Credit Given					
(d) Plus: DLR Exchange Credits					
(e) Less: Inventory Losses Realized			\$ 70	\$ 700	\$ 770
Internal Movements of Inventory	\$ 3,350			(\$3,350)	\$ -0-
(2) Less: Ending Inventory	\$10,500			\$ -0-	\$10,500
(a) Plus: Ending Allowance	<u>\$ 2,677</u>				<u>\$ 2,677</u>
Cost of Goods Sold	\$16,950		\$-0-	\$ -0-	\$16,950

**FINANCIAL STATEMENT PRESENTATION**  
**(After LAC Adjustment)**  
**MONTH TWO**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Inventory Held for Repair	Total
(1) Beginning Inventory	\$15,175		\$ 70	\$4,200	\$19,445
(a) Less: Beginning Allowance	\$ 1,502			\$1,650	\$ 3,152
(b) Plus: Purchases at Cost	\$ 7,750			\$1,500	\$ 9,250
(c) Plus: Customer Returns - Credit Given					
(d) Plus: DLR Exchange Credits					
(e) Less: Inventory Losses Realized			\$ 70	\$ 700	\$ 770
Internal Movements of Inventory	\$ 3,350			(\$3,350)	\$ -0-
(2) Less: Ending Inventory	\$ 8,925			\$ -0-	\$ 8,925
(a) Plus: Ending Allowance	<u>\$ 1,102</u>			\$ -0-	<u>\$ 1,102</u>
Cost of Goods Sold	\$16,950		\$-0-	\$ -0-	\$16,950